Response to Article

# Why Justin Lin's Door-Opening Argument Matters for Development Economics

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**A response to 'Six Steps for Strategic Government Intervention' Justin Yifu Lin***

Let there be no doubt: the fact that Lin advances a nuanced argument for strategic government intervention – as part of his larger 'new structural economics' – is an important new advance in thinking about economic development. The World Bank, of which he is the first-ever non-G7 chief economist, is now not particularly important as a source of capital for developing countries (except during global crises); but it remains very important as a source of knowledge, including knowledge of development strategy. Its research department is by far the biggest center of such thinking in the world, and other aid agencies and many NGOs tend to begin their thinking by asking what the World Bank says on the subject and, often, stopping there.

As is well known, the World Bank has long championed the set of prescriptions known as the Washington Consensus – not only at the level of words but also at the level of actions (for example, in the codification of the 'ideal' set of development policies and institutions in its Country Policy and Institutional Assessment (CPIA) formula). Central to its thinking was the proposition, first, that economic growth is a function of the size and competitiveness of markets (as distinct from Leontief's emphasis on economic growth as a function of the structure of production, for example) and, second, that government 'intervention' tends to be more costly than 'market failure', so government 'intervention' has to be carefully justified case by case.

Lin's papers are pushing at the edges of this consensus, reflecting his awareness of the inconsistencies between these propositions and the actual roles of several East Asian governments in helping to stimulate high-speed growth, as well as of governments in Brazil and in the west (including the US government in IT and defense industries).

The fact that Lin is 'disturbing the deep slumber of a decided opinion', in J. S. Mill's words, is what is really important (Mill, 1998 [1859], ch. 2). By doing so he helps to open doors for others to push more vigorously on the frontiers than he can, given his official position in a still US-dominated organization. Everything else is secondary.

Here are a few directions in which some vigorous pushing is needed, whether by the World Bank or others. First, on the supply side, is the distinction between 'existing comparative advantage' and 'future' or 'latent' or 'dynamic' comparative advantage. Most of the time Lin wishes to limit 'interventions' to helping firms exploit the opportunities offered in the existing comparative advantage – with the qualification that 'economic development is a dynamic process that requires industrial upgrading' (p. 000), a dynamic process that may change the existing comparative advantage and in which the government may have an important coordinating role. I wonder how to operationalize the distinction between existing and latent comparative advantage. Lin suggests that government and firms in country X should scrutinize the kinds of products and services produced in comparably endowed countries with per capita incomes roughly double X's, and look for promising items or processes within this set. Indeed, Japanese, Korean and Taiwanese planners did do a lot of this 'looking ahead down the river' kind of exercise. But they often took target countries much more than twice as rich as they were at the time. And today, more than when the capitalist East Asians went through their fast-growth decades, there is more 'vertical' differentiation in the production of any one product, creating niches in the production of final products which, as final products, appear to be far beyond the 'latent' comparative advantage of country X (see my *Governing the Market* (Wade, 2004)).

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This line of thinking invites serious attention to the rather neglected subject of industrial upgrading and diversification, including to the concept of stages of growth. It is remarkable how ideas about the transition from resource-based industries (for example, textiles and apparel) to heavy and chemical industries, to scale-sensitive assembly-based industries like automobiles and electronics, to Internet-based industries (all with very different appropriate roles of government) have largely disappeared from development economics. Here it is worth going back to the seminal work of the Japanese economist Akamatsu and his flying-geese theory of intra-industry evolution within one national economy and linked flying-geese theory of inter-country evolution in a hierarchical division of labor. Akamatsu published his main work before the Second World War. There is no better place to understand his arguments and see their application to development patterns of the past several decades than Terutomo Ozawa's important new book, *The Rise of Asia: The 'Flying-Geese' Theory of Tandem Growth and Regional Agglomeration* (2009). Much of Lin's thinking resonates with that of Akamatsu and Ozawa.

Another big hole in conventional development economics, which Lin and the World Bank could help to give more attention to, is on the demand side – above all, the tendency for wages to increase more slowly than productivity growth, which limits domestic demand and concentrates income and wealth at the top, distorting the economy by the efforts of the wealth holders to find ways to store their wealth (in natural resources, complex financial products, overseas bank accounts, political patronage). The World Bank could give its support to Rooseveltian measures like a legal minimum wage, cash transfers to the poor and guaranteed public sector employment at the minimum wage. The trouble is that its CPIA formula hard-wires in the assumption that a completely free, 'undistorted' labor market with virtually no worker protections is the ideal labor market for development. This needs to change.

A third – and for present purposes final – big hole in conventional development economics concerns the strong advantages of mobilizing domestic savings, as distinct from relying on foreign borrowing. For too long economists have presumed that foreign saving will help to raise domestic investment, downplaying its dangers – a presumption indirectly derived from the interests of western financial firms. No one was more adamant – and one eyed – about the need for free capital flows and for developing countries to borrow abroad to supplement domestic savings than Larry Summers, during and after his tenure as chief economist of the World Bank. One of the most eloquent arguments about the need for and methods for boosting domestic savings is set out by the Brazilian economist Luiz Carlos Bresser Pereira, in *Globalization and Competition: Why Some Emergent Countries Succeed while Others Fall Behind* (2010).

But these latter topics – inequality of income and wealth, employment protection and the hazards of borrowing from western banks – are touchy subjects for the World Bank and some of its shareholder governments. Let us hope that Justin Lin will use his influence to advance quietly the frontiers of understanding on these subjects, too, crossing the river one stone at a time.

## References

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